

# Cooperative Director Responsibilities - To The Auditor - To The Member\*

By

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It is an honor for me to participate in your annual meeting. Despite this honor, the topic your committee asked me to speak on made me reluctant to accept the assignment as each of you are so knowledgeable on the subject. However, after giving further consideration to the topic, I recognized that you as auditors and I as an educator are really trying to reach the same objective - helping farmers to operate and use their cooperative as an effective tool of modern agriculture.

I have a unique and very interesting position with the Ohio Cooperative Extension Service, and the College of Agriculture at The Ohio State University. One-fourth of my time is allocated to teaching undergraduates and graduates about cooperatives as one of the ways of doing business in our competitive economy. As an extension specialist, I have the opportunity to use one-fourth of my time to teach members, directors and employees of cooperatives about cooperatives. I am not an auditor nor a CPA nor an attorney.

As an Extension Economist with responsibility to plan and conduct educational programs, to prepare farmers to more effectively organize and operate their cooperative, I feel I have an obligation to address this subject as I consider it a topic of increasing importance.

In the selection of an auditor for a cooperative, I have an open mind --- but it is made up; I have said for years that a prudent board of directors of a cooperative will only engage an auditor who is a member of the National Society of Accountants for Cooperatives. My reason for this is that I have found too many sincere, hard working cooperative directors and managers in difficulty because their auditor didn't know what a cooperative was and had no knowledge of cooperative principles, laws, and tax regulations. I believe that every auditor of a cooperative should receive and read your official quarterly publication "The Cooperative Accountant" and participate in your national and chapter meetings. My students are given the opportunity to read and discuss many of the timely articles published in your official publication "The Cooperative Accountant", and I thank you for the privilege of using this excellent material in my class.

The topic, "The Board's Responsibility to the Auditor and Members" provides me an opportunity to express some of my opinions and also to explore how we might together improve the operation of agricultural cooperatives.

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One definition of a director that I like is "A director has a fiduciary duty to the corporation and to its stockholders to manage the affairs of the corporation in a manner which is consistent with their interests. Any breach of this fiduciary duty may subject him to personal liability to both shareholders and the corporation."1/

I will not devote much time to reviewing with you all the responsibilities of directors as you are already knowledgeable of them and I have written and spoken on directors' responsibilities many times.2/ However, in order that we may approach this topic together I do want to give a few of the basic responsibilities of cooperative directors that I trust we can have agreement on:

- The board of directors is charged with the responsibility for exercising all the authority of the corporation, its management, the safeguarding of the cooperative's assets and the conduct of its business. The board of directors is, in fact, the only group of persons in whom this authority is vested.
- The acceptance of an obligation by an individual to serve as a director of his cooperative implies that he recognizes and accepts the responsibilities of the position. (From my observations, too many directors do not know or recognize their responsibilities when they accept the honor of being a cooperative director.)
- Cooperative directors have those specific responsibilities set forth in the state statute and in the cooperative's Bylaws.
- Cooperative directors should know and discharge their responsibilities to the best of his ability.
- When a member of a cooperative is elected by his fellow members to a position on the board of directors he faces a two-fold challenge:
  - (1) To represent all stockholders or members of the cooperative, not just himself or only the members of his district but the total membership.
  - (2) He is vested by law with the responsibility to reasonably conduct the affairs of the business for the welfare of the cooperative.

Assuming we agree on those basic responsibilities of cooperative directors, let me point out what I believe are some responsibilities to auditor and members. For a director of a cooperative to successfully discharge his

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1/ Law Directory, Steven Gefets, page 60.

2/ Duties and Responsibilities of Managers and Directors, C. H. Ingraham, ESO 480, Department of Agricultural Economics and Rural Sociology, The College of Agriculture, The Ohio State University, Columbus, Ohio

responsibilities he needs accurate financial information about his cooperative which is adequate to enable him to evaluate the results of management's implementation of the board's policies. However, it is not sufficient that the financial information about the cooperative be accurate and adequate - all members of the board must be able to understand, interpret and use it effectively.

The directors of agricultural cooperatives are farmers. For the most part, they are well educated and successful operators of their own farm business. They know about operating costs, depreciation, financing, and other matters necessary for a successful farming operation. Their responsibilities of managing a successful farm require much of their time; however, they have a responsibility as directors of their cooperative to take the necessary time away from their farming operations in order that they may discharge their responsibilities as directors of their cooperative. This does not mean allocating just enough time to attend board meetings but they must allocate sufficient time to prepare themselves to discharge their responsibilities at the board meeting in a professional manner.

To be more specific, a cooperative director has a responsibility to the auditor, the membership, and to himself; to know and understand what a cooperative is. All directors must understand the basic principles that differentiate cooperatives from other types of businesses that operate in our competitive economy, (operations at cost, limited return on equity capital). Cooperative directors are responsible for knowing about the special rules and regulations for managing a cooperative. Directors are responsible for operating the cooperative within the provisions of the law, the Bylaws, membership and marketing agreement of the cooperative, plus all the regulations of agencies such as OSHA, EPA, SEC, IRS, etc. It is the board's responsibility to seek out and employ competent advisors as the need arises.

Directors of cooperatives are responsible for engaging the services of a competent cooperative auditor and for instructing the auditor as to what they want in the total audit and to use the information they receive from their auditor.

Directors, themselves, are not required to be accountants or bookkeepers but they are responsible for employing a competent auditor and understanding and using the financial reports they receive about their cooperative.

It is a responsibility of the board of directors to select and engage the outside auditor. I told you earlier one of my requirements is that the auditor be a member of The Society for Cooperative Accountants.

The board of directors is responsible for providing the leadership in planning for the audit with their auditor. The audit request must be made well in advance of the commencement date and spell out the scope of the audit desired. The extent of the audit, the form and content of the auditor's final report should be determined after a discussion with the auditor, management, and the board of directors well before the audit is to be made.

The board should arrange for an oral conference with the auditor they select to discuss and arrive at general agreement on the scope of the audit

and procedures to be followed. These conferences should be held far enough in advance of the fiscal year closing to permit all involved to secure the various schedules the outside auditor requires to meet the demands of the board. There must be sufficient time for the preparation of the necessary material in advance and so it will be ready for the auditor when he is scheduled to arrive. The board should establish with the auditor and management a time schedule so all involved will know when their respective assignments need to be completed to permit the auditor to start to work immediately upon arriving at the cooperative. These oral conferences should produce a general agreement on a completion date and maximum cost of the audit. Care should be taken to avoid limiting the scope of the audit because of pressure to keep the cost of the audit at a minimum. Management should participate in this oral conference and in the preparation of the engagement letter. Most auditing firms have their own standard engagement letter; however, it can and should be modified to the specific requirements of the situation.

The board has the responsibility to the auditor to make sure that management has the necessary accounting records up-to-date and complete in every respect as scheduled in the oral conference.

The board has the responsibility to the auditor to see that management makes the necessary arrangements for adequate working facilities for the auditor and for cooperation between the cooperative staff and the auditor.

Other responsibilities of the board to the auditor are: Provide for a complete inventory verification; Provide for verification of Accounts Receivable; Provide copies of all board policies; Provide for sufficient time to review the final report with the auditor; Listen to problems surfaced by the auditor and determine the reasons for the problems; Know and understand what the auditor is saying, ask questions and follow through on his recommendations.

The board is responsible for arranging for the auditor to have direct access to the board of directors at all times.

The board must arrange for complete and accurate minutes of all meetings. The minutes of the board of directors should relate the board's actions on association business. Authority for action of the officers of the cooperative and its employees should be found in the minutes of board meetings.

It is a responsibility of the board to see that each meeting of the board is properly conducted within the parameters of the law, articles of incorporation, and Bylaws.

It is a responsibility of the board to make the articles, Bylaws, minutes of all meetings, and all their written policies available to the auditor.

The board should provide for an on-going relationship between the cooperative and the auditor from the close of one audit to the start of another. This should include making available to the auditor those things that will keep the auditor aware of the firm's activities. The board should provide the

auditor with copies of all interim financial reports, review with the auditor any new business ventures or practices in an effort to avoid problems with taxes and exemptions. The board should arrange for the auditor's assistance as needed in developing or improving the cooperative's procedures.

The board is not only responsible for engaging the auditor but also for having the audit report delivered by the auditor to the board. The board should arrange for the auditor to meet with the board in executive session.

I feel it is important that cooperative boards of directors have adequate and accurate financial information about their cooperative; a competent cooperative auditor can provide this - but that is not enough - this financial information about the cooperative must be used by the board. In order to use the financial information that the auditor provides the board of directors, they must understand it. The contractual arrangement with the auditor should provide that the auditor deliver his report to the board in the manner and form necessary for each member of the board to understand the entire report. The cost of explaining the report to the board should be included in the cost of the audit. Each member of the board should be capable of presenting the audit to the membership at the annual meeting or in one-on-one contacts with members.

Cooperative directors have a responsibility to the membership to discharge their responsibilities in a professional manner. Cooperatives are a competitive business operating in our dynamic free competitive economy and require sound professional management from their board of directors.

Cooperative directors are entrusted by the membership with the general welfare of their cooperative and have a responsibility to the members to act in their best interest.

Cooperative directors have a responsibility to their membership to secure an unqualified audit from qualified auditors.

Cooperative members need certain financial information about their cooperative. It is the board's responsibility to provide complete and basic financial information to the members of the cooperative in a form and manner that members can understand.

The reports by the board should contain sufficient information to enable members, patrons, investors, creditors, and other interested parties to obtain a general understanding of the financial position and operating results of the cooperative.

Cooperative directors have a responsibility to the membership to use the audit as a tool to assist them in determining whether the association is being operated in accordance with its charter, Bylaws and written policies.

Outside auditors are to be engaged by the board to represent the members of the cooperative but in some cases the outside auditors are engaged by management. There is some interest in boards establishing auditing com-

mittees to make accounting firms more independent of the companies they work for. Auditors can discharge their responsibilities to the members with or without an audit committee if boards of directors accept and carry out their responsibilities to the auditor and membership.

Now that I have delineated the responsibilities I believe that the board has to the auditor and to the membership, where do we go from here? Let me assume that you agree with most of the concepts I have presented. The question is how can we get cooperative boards to assume and discharge these responsibilities? I think education can be an answer.

Education is not a one-shot deal. I think you and I need to, in our own way, continue to advise directors about their responsibilities and suggest practices that they might employ to more effectively discharge their responsibilities. We need to encourage cooperative board members to participate in educational activities designed to help them improve their effectiveness as directors.

Cooperative directors have the responsibility to prepare themselves to discharge their responsibilities and I think a cooperative director should have a philosophy of "What's best for farmers, rather than what's best for me".

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